Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of:		
	)	
Federal-State Joint Board On	)	
Universal Service Seeks	)	**CC Docket No. 96-45**
Comment On Certain Of The	)	**FCC 04J-2**
Commission's Rules Relating	)	
To High-Cost Universal Service	)	
Support	)	

Released: August 16, 2004

Comments Of:

Fred Williamson and Associates, Inc. ("FW&A")

October 15, 2004

I. BACKGROUND AND SUMMARY OF COMMENTS

Fred Williamson and Associates, Inc. is a consulting firm that serves rural Local Exchange Carriers (LECs) in Kansas and Oklahoma. The areas served by the rural LECs represented by FW&A (rural LECs) are areas with low population densities that are costly to serve. Universal service revenue is a major portion of the recovery of the high costs of service for these rural LECs. This revenue is absolutely vital to the rural LECs for the maintenance of universal service through the delivery of affordable telecommunications service and for the promotion of investment in infrastructure that is capable of delivering advanced telecommunications services. It is critical that the Joint Board recommend rules that do not jeopardize nor compromise the existing universal service support mechanisms that allow rural companies predictable and sufficient recovery of the costs associated with providing universal service. In response to the Public Notice[1], FW&A respectively submits these comments that: 1) Recommend modifications to the definition of "rural" for universal service purposes to add a criterion that reflects the statewide population density of areas served by eligible telecommunication carriers (ETC); 2) Support the continuation of the use of embedded costs for determination of Federal Universal Service support for rural LECS; and 3) Recommend changes to the section 54.305 rules concerning transferred exchanges that will further facilitate additional investments in the rural infrastructure and further promote the availability of advanced telecommunications services in rural areas.

[1] Public Notice, FCC 04J-2, Federal-State Joint Board On Universal Service Seeks Comment on Certain Of The Commission's Rules Relating To High-Cost Universal Service Support, CC Docket No. 96-45, Released August 16, 2004 (Public Notice)

II. DEFINITION OF "RURAL" FOR UNIVERSAL SERVICE PURPOSES

The Joint Board seeks comment on whether the Commission should continue the use of the statutory definition of "rural telephone company" to determine which carriers are rural for high-cost universal service purposes. [2] The current definition of a rural carrier is as follows:

> (A) Provides common carrier service to a study area that does not include either:
> (i) Incorporated place of 10,000 or more, or any part thereof, based on the most recently available population statistics of the Bureau of the Census; or
> (ii) Any territory, incorporated or unincorporated, included in an urbanized area, as defined by the Bureau of the Census as of August 10, 1993;
> (B) Provides telephone exchange service, including exchange access, to fewer than 50,000 access lines;
> (C) Provides telephone exchange service to any local exchange study area with fewer than 100,000 access lines; or
> (D) Has less than 15 percent of its access lines in communities of more than 50,000 on February 8, 1996.

The current definition focuses primarily on population and the number of access lines contained in study areas that do not include urban areas or incorporated areas of 10,000 or more. Since the definition focuses on defining companies that serve small study areas (exchanges with less than 50,000 lines and study areas with less than 100,000 lines) as rural; it has generally identified companies that serve rural areas. While the majority of providers that predominantly serve rural areas are classified as rural under the current definition[3], an additional criterion, based on the density of the all study areas served by a

---

[2] Id. Para. 8.

[3] The majority of rural LECs that serve high cost areas are NECA Pool members. In the *NECA Rural Broadband Cost Study*, released in June of 2000, NECA observed the following: "Based on the 1996 Telecommunications Act, the FCC has recognized 95 non-rural and 1301 rural LEC's (The latter includes both NECA and non-NECA companies.) Of the 1301 LEC's 111 are companies NOT in the CL (Common Line Pool.) A further investigation indicates that an additional 49 NECA LEC's were omitted from the FCC's rural/nonrural list. Therefore, a total of 1239 (1301-111+49) of NECA's CL pool members are rural." Thus, under the current definition, based on NECA's observations, there are approximately 1,350 rural LECs and 1239 or 92 percent are NECA CL Pool members. Based on this data it is reasonable to

service provider throughout a State can be employed and eliminate some of the anomalies that occur under the current definition that are identified in the Public Notice.[4]

The key driver of high costs of providing services is the population density of the area served. Rural areas are characterized as those areas with low population densities. For example, the access lines per square mile for the rural areas served by FW&A's clients range from 1.4 lines per square mile to 10.5 lines per square mile. Additionally, NECA reported in its 2003 Access Market Survey that over half of its Traffic Sensitive Pool members serve less than 10 lines per square mile and the remaining members fall within the following ranges of lines served per square mile: 11 to 20 – 20.6%; 21 to 30 – 10.7%, 31 to 40 - 5.3 %; and over 40 -14.4%.[5] The access lines served in these areas reflect the fact that the population densities for the majority of the areas served by rural LECs are well below the average population per square mile for the United States (79.6) [6] and are significantly below the average population densities of metropolitan areas within the United States (320.2). Population density was also a key difference between rural and non-rural carriers that the Rural Task Force (RTF) identified in their analysis and recommendation previously made to the Joint Board.[7] The low population densities

---

conclude that the current definition has done a reasonable job at identifying LEC's that serve high-cost rural areas.

[4] The Joint Board states in the Public Notice that 40 companies serving study areas with more than 100,000 access lines, including one company serving 2 million access lines self certified as rural under the current definition. In contrast, companies that only serve a single study area in a state that exceeds the 100,000 access line threshold are classified as non-rural. (Public Notice, Paragraph 8)

[5] See NECA 2003 Access Market Survey – Fulfilling the Digital Dream, A Report on Technology Deployment at Rural Telecom Companies, Prepared by NECA's Technology Planning and Implementation Group. (http://www.neca.org/source/NECA_155_1152.asp)

[6] Source: US Census Bureau, Census 2000.

[7] See Federal-State Joint Board on Universal Service, CC Docket No. 96-45, *Rural Task Force Recommendation To The Federal-State Joint Board On Universal Service*, Released September 29, 2000 (RTF Recommendation), Page 11.

translate into high costs for providing service to customers located in the rural LECs' service areas, due to small numbers of customers being located along facility routes. Put simply, if a company invests $100,000 in a cable route that serves 300 customers, its investment per customer is approximately $333. In comparison, if a company invests $100,000 in a cable route that serves 10 customers, its investment per customer is $10,000. It is clear that serving areas with low population densities translates into high costs for the carrier providing telephone service to these areas. Thus, population density can be used as a key indicator of whether the areas served by an ETC are rural and high cost areas for purposes of determining universal service support.

The current definition does not focus on population density, but rather focuses on the size of the study area. While small study areas are typically rural, there are exceptions where the area served may be densely populated and not consist of rural characteristics. In the Public Notice, the Joint Board stated that they were interested in "the extent to which each of the four subparts of the definition accurately identifies companies that serve fewer subscribers, serve more sparsely populated areas, and generally do not benefit as much from economies of scale and scope."[8] The current definition only identifies those LECs that serve small study areas. The definition does not contain criteria that allow identification of whether the population of areas served is sparse nor does it include criteria that identify economies of scale and scope. FW&A recommends that the current definition be supplemented with a criterion that would assess the population density of the study areas served statewide by an ETC. Under this approach, the definition would more accurately depict those rural service providers that serve areas with sparse

[8] Public Notice, Para. 8

population densities and do not benefit from economies of scale and scope. If a carrier provides service to study area(s) with population densities that reflect rural characteristics - let's assume less than 100 people per square mile - they would be treated as rural for purposes of determining universal service support. On the other hand, if a carrier serves one study area in the State with a population density of 50 people per square mile and another study area in the same State with a population density of 300 lines per square mile, this carrier may not be classified as rural due to the statewide average population density of its service areas possibly exceeding 100 per square mile. This also reflects that this carrier, by serving areas with high population densities and more customers, may benefit from economies of scale not typically available to service providers that provide service exclusively in rural areas.

FW&A recommends that the Joint Board evaluate utilizing a statewide service area population density of 100 persons per square mile as a guideline for establishing whether a carrier in a State is considered rural for purposes of determining universal service support. This is consistent with the baseline definition established by the Commission recently for purposes of promoting wireless services in rural areas. Specifically, the Commission established "a baseline definition of "rural area" as those counties (or equivalent) with a population density of 100 persons per square mile or less, based on the most recently available Census data." [9] While, this definition was based on county boundaries for purposes of promoting availability of spectrum in rural areas, the 100 person per square mile definition is an initial guideline that should be evaluated by the

[9] See Report and Order and Further Notice of Proposed Rule Making, Released September 27, 2004, WT Docket Nos. 02-381, 01-14, and 03-202, paras. 10 – 12.

Joint Board for the definition of rural. A population density criterion is also consistent with findings of the RTF. In their report the RTF stated, "[t]he average population density is only 13 persons per square mile for areas served by Rural Carriers compared with 105 persons per square mile in areas served by non-Rural Carriers."[10] Based on the record in this proceeding and findings of the Joint Board, this criterion could be modified, if necessary to more accurately define rural areas for universal service support purposes.

Assessment of population density on a statewide basis for evaluation of whether a carrier is rural is a reasonably sized area for such a purpose. This is a consistent fit with many of the current regulatory processes and the division of responsibilities between the FCC and State Commissions that regulate local exchange carriers on a state by state basis. Defining rural and targeting support on a statewide basis fits well with the existing regulatory scheme.

The Joint Board seeks comment regarding whether they should consider holding company size, as well as study area size, when identifying companies that generally do not benefit as much from economies of scale and scope as the large non-rural companies.[11] Similarly, the Joint Board requests comments regarding whether the Commission should differentiate for high cost universal service support purposes between small, medium and large companies.[12]

[10] RTF Recommendation, Page 11
[11] Public Notice, para. 13
[12] Id. para. 14

FW&A does not see any need to make such differentiations. As discussed above, the current rules with the recommended modification should accurately identify rural and non-rural carriers. For rural carriers (carriers whose statewide operations meet rural criteria), that base support on embedded or actual cost, any economies of scale that are achieved as a result of the statewide operations being part of a larger holding company are appropriately accounted for in the current cost calculations. The actual costs that are utilized for determination of universal service support will reflect savings that are realized in corporate expenses and other fixed costs as a result of the service areas being operated by a holding company. Similarly, for the rural carriers, any economies of scale that are achieved as a result of a carrier being larger in size are also accounted for in the embedded cost calculations. Differentiations based on holding company status and/or carrier size would also add unnecessary administrative complexities to the process.

The Joint Board seeks comment on the impact of changing the definition of rural carriers.[13] If a carrier, as a result of changing the definition of rural is classified as non-rural, it should be subject to the same rules for Universal Service support that are currently applicable to non-rural carriers. In this case, these carriers would be subject to the forward-looking cost mechanism rather than an embedded cost mechanism. Carriers impacted by the change in the definition of rural should have the option to flash-cut to the forward-looking cost-based support levels on the effective date or to transition to the new support levels over a five year period. This would allow the carrier time to adjust to any significant changes in support levels and possibly avoid sudden and large impacts on rates these carriers charge to their customers.

[13] Id. Para 17

III. UNIVERSAL SERVICE SUPPORT IN AREAS SERVED BY RURAL CARRIERS

1. Cost Basis of support

a. Forward-Looking Economic Costs (FLEC) versus Embedded Costs

With respect to determination of support amounts for Universal Service, the well researched findings of the RTF supporting the continued use of embedded costs remain valid today. There is no compelling reason to jeopardize universal service support for rural local exchange carriers through the adoption of a forward-looking cost mechanism. FW&A supports the continuation of the use of embedded costs for carriers that meet the rural definition as the approach that best meets the Act's goals.

The Joint Board seeks comments regarding which cost method best promotes rates in rural areas that are comparable to urban areas.[14] Embedded cost of service (ECOS) better ensures the reasonable comparability of rates as it is based on the actual cost levels of the service provider. FLEC is generalized and could significantly underestimate or overestimate a service provider's costs. Without sufficient recovery of its actual costs, a rural service provider may not be able to charge amounts that reflect affordable rates and local rates that are comparable to rates charged in urban areas. FLEC is a hypothetical depiction of a carrier's cost. Only actual or ECOS can serve as a reasonable basis to ensure that a rural LEC receives sufficient and predictable support that is necessary for maintenance of affordable rates. ECOS will ensure, unlike FLEC, that support is not based on costs that are neither too high nor too low, but the actual costs that a carrier incurs to provide service.

[14] Public Notice, Para. 21

The Joint Board requests comment on whether a rural support mechanism that bases support on forward-looking economic costs or on embedded costs better ensure the availability of service in rural areas that are comparable to urban areas. Further, the Joint Board asks whether basing support on FLECs remain integral to providing appropriate incentives for investment, innovation, and entry into the marketplace.[15]

The availability of service and incentives presented by use of an FLEC approach would be subject to the accuracy of the costs or the ability of the model to depict the actual cost levels that are incurred to provide universal service. If the hypothetical FLEC result substantially overestimated costs and thereby increased support payments to ETCs, they would have more support than justified by actual costs, and could choose to spend inefficiently and unnecessarily or possibly retain excessive profits. Additionally, competitive disadvantages could result from ETCs with excessive support payments using this support to cut prices for competitive services. If the FLEC based support is below a carrier's actual costs to provide service, the ETC has no choice but to reduce or eliminate its investments in the network and thereby derogate the quality of service. Alternatively, the ETC could increase local service rates and possibly threaten the availability of affordable rates in its service area. FLEC could impose significant risks to rural LECs. Embedded cost of service strikes a more reasonable balance in encouraging incentives for investing in the network and maintaining affordable rates, since a carrier's support is based on actual costs – nothing more and nothing less.

[15] Public Notice, Para. 21

Embedded costs have produced appropriate incentives for rural LECs to upgrade their networks so they are capable of delivering advanced services. Use of embedded costs enables rural LECs to recover the actual costs of network upgrades that are necessary for the deployment of advanced services.[16] Forward-looking costs are hypothetical and depend on assumptions regarding network costs. As the RTF findings show, discussed below, these costs are inaccurate and in many cases will be insufficient and not provide rural carriers with incentives to build networks that are capable of delivering advanced services.

The Joint Board seeks comment on whether there are other uses for forward looking costs. In the Public Notice they ask whether support should be capped at the lesser of embedded or forward-looking costs.[17] Capping at the lesser of the two costs would be unacceptable for the same reasons that were discussed above. As stated above, in cases where the forward-looking costs underestimate costs, this would lead to insufficient universal service support for rural LECs. Additionally, since support would not be sufficient to recover actual costs of the network, rural LECs would not have incentives to invest in networks that are capable of delivering advanced services.

[16] All of FW&A's rural LEC clients have deployed facilities that are capable of delivering broadband services to customers. Most of these companies have deployed, or will deploy in the near future, broadband services to all customers located in their service areas, including those in the most remote locations. For those not deploying broadband to all customers, over 80% of the customers will have broadband services available. In the future, the continued advancement of technology and the availability of sufficient universal service support will likely enable deployment of broadband to all customers served by these companies.

[17] Public Notice, Para. 24

b. Estimating Forward-Looking Costs

FW&A does not support the application of forward-looking costs to LECs or ETCs that are defined as rural. FW&A is not aware of the existence of a forward-looking cost model that accurately depicts the costs of providing universal service for rural LECs. If an alternative model is developed or significant modifications are made to the FCC Synthesis Model, the RTF should be reconvened to evaluate the sufficiency of model for purposes of calculating universal service support for rural LECs. A key component of this evaluation is that the forward-looking cost model should accurately depict the actual network characteristics that exist for rural LECs and the lack of economies of scale in rural areas. The discrepancies with the Synthesis revealed in the RTFs analysis, discussed below, should be corrected or accounted for if a forward-looking model is employed to determine rural LEC universal service support. Additionally, actual costs incurred by rural LECs should be used to evaluate the reasonableness of forward-looking cost estimates produced by any models proposed in this proceeding.

The only forward-looking cost model of public record available for determination of universal service costs is the FCC's Synthesis Model that is employed for non-rural LECs. Most other forward-looking models that FW&A is familiar with, mainly the Benchmark Cost Proxy Model and the HAI Model (also referred to as the Hatfield Model) have not been updated and are not models that are currently utilized for determining federal universal service support. These models were rejected by the Commission when a costing mechanism was established for non-rural LECs. However, the Synthesis model utilized selected components of the HAI Model. FW&A is not

aware of the availability of other forward-looking models that the FCC could deploy to determine universal service support for rural LECs. The FCC Synthesis remains the only viable model that is available to produce forward-looking cost estimates for determining universal service support. The RTF analyzed the Synthesis Model to determine whether it reasonably depicted cost of providing universal service for rural LECs. In Summary, the findings of the RTF determined the following with respect to the use of forward-looking cost models for rural carriers:

- The model did not accurately estimate the actual lines served.
- The model inaccurately estimated the route miles of plant. There were significant variations between the estimates produced by the model and actual facilities deployed by rural LECs. In general the model had a tendency to overestimate route miles.
- The model, in most cases, significantly understated the land area served by a wire center.
- The model significantly understated central office switching investment.
- Estimates of general support investment varied widely from actual data and from rational forward-looking assumptions.
- Network Operations and Customer Operations expenses were significantly underestimated and failed to reflect the lack of economies of scale of rural LECs.

In summary, the RTF concluded:

> "The aggregate results of this study suggest that, when viewed on an individual wire center or Individual Rural Carrier basis, the costs generated by the Synthesis Model are likely to vary widely from reasonable estimates of forward-looking

> costs. As a result, it is the opinion of the Task Force that the current model is not an appropriate tool for determining the forward-looking cost of Rural Carriers."[18]

Since the RTF performed its analysis and documented its conclusions, the FCC has not made changes to its Synthesis Model that will significantly correct the problems for rural LECs identified by the RTF.[19] The RTF in its analysis estimated that if the FLEC approach that is currently utilized for non-rural LECs were applied to rural LECs, the high cost fund support available to rural LECs would have been reduced from $1.553 billion to $451 million. A significant portion of this reduction was due to use of the benchmarks and statewide cost-averaging.[20] Nevertheless, it is unlikely that the forward-looking model could ever be built in a manner that it could accurately depict costs or the diversity that exist for rural LECs nationwide. Exhaustive efforts were made to construct accurate forward-looking models subsequent to implementation of the Telecommunications Act of 1996. These efforts failed to produce a model that accurately depicts universal service costs for rural LECs. There is simply no basis for utilizing forward-looking costs to estimate universal service costs for rural LECs. Use of inaccurate cost estimates, especially those that significantly understate actual costs, cannot be relied upon to produce universal service support to rural LECs that is sufficient for the maintenance of affordable rates and will fail to meet requirements contained in the Act. Embedded costs continue to be the best option for determining universal service

[18] RTF Recommendation, Pages 17 - 18
[19] Moreover, it is difficult for small rural LECs to obtain information that is necessary to process and evaluate the model results. Unless, access is provided to critical data bases containing wire center boundaries and customer location data that is employed in the Synthesis Model, it is not possible to evaluate the Synthesis Model results for specific LEC serving areas. To obtain access to this data, users must subscribe to software and data bases through a private vendor and pay appropriate charges. For small companies access to this information is expensive and in some cases cost prohibitive.
[20] RTF Recommendation, Page 19

support for rural LECs that is sufficient for the recovery of the costs of providing universal service.

If the Commission were to adopt a forward-looking approach for rural LECs, the model would need to be much more dynamic than the current synthesis model that is used for non-rural LECs. Several sets of inputs, rather than a single set as used for non-rural LECs would have to be used for the model to have a chance at reasonably depicting a rural LEC's costs. For example, small carriers have less purchasing power than larger carriers and alternative inputs for plant and equipment costs are necessary. Fixed expenses and support investments per line for a LEC that serves 200 lines are likely to be substantially higher per line than a LEC that serves 5000 lines. Such differences would have to be accounted for in the model. Accurate customer location data would be necessary for the proper depiction of the amount of network facilities that are necessary to serve all customers located in the LEC's service area. In summary, it would be difficult to fashion a single set of input data that would be appropriate for any rural LEC. Again, if an FLEC Model is employed for rural LECs, the RTF or similar task group should be convened to review the model and estimated costs to ensure rural LECs' costs are depicted as accurately. Accurate cost depiction is vital to ensure that the availability of universal service in rural areas is not harmed.

The Joint Board asks whether a FLEC cost model should reflect the availability of telecommunications provided by ETCs using wireless technology.[21] If a wireless carrier is defined as non-rural it should be required to utilize FLEC costs and related support

[21] Public Notice, Para. 32

mechanisms that are applicable to non-rural carriers. If the FLEC model for wireless services, whether separate or as part of an existing model, is developed, this would certainly depict a more reasonable level of support for these carriers and areas where deployment of wireless service is more economical. Fundamental to the receipt of support by an ETC, there should be a demonstrated need for support based on cost. If the wireless technology is the lowest cost, it would be consistent with FLEC principles to use it in lieu of the wireline costs in non-rural areas. If the wireless provider is defined as a rural provider, its support should be based on its ECOS similar to the rural LECs. These providers, like rural LECs, should file the necessary cost support similar to that outlined in Part 36, Subpart F of the Commission's rules to substantiate any claims for universal service support. Alternatively, if the wireless provider does not want to file its own costs, it could elect to base its support on the incumbent's amounts. In this case, provisions similar to those specified by the Rural Telephone Associations in comments previously filed in this Docket should be applicable. These provisions allow the receipt of support based upon the wireline-to-wireless support ratio that applies to a particular "tier." [22]

[22] In Comments filed with the Federal State Joint Board on August 6, 2004 in Docket 96-45 the associations proposed movement towards a cost-based system for determining support for CETCs that utilizes a tiered series of safe harbor ratios for predetermining per-line support. If CETC's would elect to not file their own costs they would be subject to the following provisions:

Tier IV Wireless Carriers - Carriers that have 100,000 or fewer subscribers would be eligible to receive 80 percent of the study area average per-line support received by the incumbent local exchange carrier (ILEC) that offers service to the customer.

Tier III Wireless Carriers - Carriers that have between 100,001 and 500,000 subscribers would be eligible to receive 40 percent of the study area average per-line support received by the ILEC that offers service to the customer.

Tier II Wireless Carriers - Carriers that have over 500,000 subscribers, but do not possess a national footprint would be eligible to receive 20 percent of the study area average per-line support received by the ILEC that offers service to the customer.

c. Measuring Embedded Costs

FW&A supports the retention of ECOS for rural LECs beyond the five years of the RTF plan. As stated previously in these comments, use of ECOS will best ensure the availability of sufficient support for the availability of universal service in rural areas. There is no need for significant changes to the current ECOS mechanism employed by rural LECs. The current mechanism has provided for universal service in rural areas and provided rural service providers with incentives to invest in network upgrades that allow the delivery of advanced services. The cost mechanism employed for rural LECs is not broken and does not need to be fixed.

The Public Notice requests comment regarding whether there are any alternative methods of developing costs for rural carriers without requiring that rural carriers file actual cost data. For example, could proxy data such as counts, line density, or other measures be used to determine the cost of serving high-cost areas served by rural carriers?[23] The use of proxy data would likely be too generalized and would likely fail to depict the diverse characteristics of rural carriers. There are too many variables that drive costs. Even the Synthesis Model, which has hundreds of inputs, fails to accurately depict universal service costs for rural LECs. Proxy methods would be a step backwards. The depiction of costs based on a few proxy items would be arbitrary and not produce accurate costs.

Tier I Wireless Carriers - Carriers with a national footprint would receive 0 percent support.

[23] Public Notice, Para. 34

This arbitrary cost depiction would likely misestimate costs and not ensure that rural LECs receive sufficient universal support levels.

d. Basis of Support for Competitive LECs

The Joint Board seeks comment on the methodology for calculating support for ETCs in competitive study areas.[24] As stated previously, FW&A believes that CETCs should receive support based on their costs of providing universal service. As a matter of principle, it is inappropriate for CETCs to receive support without demonstrating a need. However, if the CETC elects not to file its own costs, then FW&A believes, as stated previously, that an alternative, as suggested by the Rural Telephone Associations, that bases support on the incumbent's costs, but subject to adjustments by tier of carrier is a reasonable approach. A carrier that has elected to meet universal service obligations should have the ability to recover its costs. In the event that costs differ for carriers, support, by being based on a common benchmark, will put them on equal footing in the marketplace. By allowing the CETC the option to recover its actual costs, universal service support levels would not serve as a barrier to entry. However, if support is arbitrarily provided to CETCs based on the incumbent's costs, and the CETC's actual costs are lower, this provides the CETC with a significant competitive advantage. The intent of support should be to allow the provider to recover the costs of universal service that is made available, not to subsidize the creation of competition in the marketplace. If a CETC bases its support on its own (actual) costs, it is only fair that support not be limited to the incumbents' levels, if they are lower. This could impede the CETC's ability to recover the costs of providing universal service. Additionally, CETCs could be

[24] Id. Para. 36

inadvertently prevented from upgrading their networks, if the incumbent's support levels are not sufficient to fund such upgrades.

If support is provided to CETCs based on their own costs, the Joint Board questions how those costs should be determined.[25] As stated previously if CETCs are defined as non-rural, they should be subject to the FLEC model for cost determination. On the other hand, if the CETC is defined as rural, they should be required to file costs as defined in the Commission's Part 36 Rules, Subpart F for determination of costs. While these rules may not neatly fit all CETCs, they establish reasonable guidelines for cost determination and can be fashioned so they can be used by all ETCs. CETCs should have accounting records that identify the investments employed, expenses and other costs incurred to provide service. Based on this accounting information and additional studies, CETCs should be able to determine the costs of providing universal service in a manner that is similar to that currently used by the incumbent LECs.

2. Calculation of Support

The Joint Board seeks comment regarding the calculation of support for rural carriers. Comment is sought regarding whether the calculation of high-cost support for rural carriers should be based on individual carriers' study areas costs. FW&A supports the use of individual study area costs as a reasonable basis for rural carriers to calculate support. This fits with how rural carriers account for costs and eases the administrative burden of filing data supporting universal service costs. If the calculation of costs were required to be on a basis other than a study area, such as wire center, exchange, or census

[25] Public Notice, Para. 37

block, this could impose unnecessary administrative burdens on rural LECs, since accounting records are not typically maintained below the study area level. This issue is discussed in further detail in comments below.

The Joint Board asks whether the current rural universal service support mechanism provides appropriate incentives for investing in network and facilities and functions used to provide supported services. The current mechanism has functioned well in providing such incentives. In the NTCA 2004 Broadband/Internet Survey, it was reported that 92% of the rural service providers provided broadband services to some part of their customer bases. The majority of this deployment was made using DSL technology while some reported use of fiber to the home and wireless technologies. In 2000, the number of respondents providing broadband services was 58%. As noted previously, FW&A's rural clients have also significantly deployed advanced services in their service areas.[26] Without universal service support, such significant deployments of advance services may not be viable.

The Joint Board seeks comment on whether the current support mechanism by basing support on per-line costs, creates inefficiencies by increasing support when rural carriers have declining line counts. Support is provided to insure that a network exists to provide universal service in rural areas. And it would be more efficient to base support on the number of voice-grade network connections that are available in a LEC's network whether they are in service or not. As a result the support per unit would not decline as line counts (in-service) decline. Network connections would fluctuate less than line

[26] See Note 16

counts and would also be consistent with how the network is built. Network connections would typically only increase as the network is built to serve new homes, businesses, etc. Use of connections would avoid the unintended consequence of increasing the support per line, even though overall, costs have not increased.[27] However, the real cause of inefficiency is that CETCs under the current rules receive support based on the incumbent providers' costs per line. If the rules were modified to require CETCs to receive support based on their own costs, as FW&A recommends in these comments, inefficiencies would be reduced dramatically.

In response to the Joint Board's inquiry regarding which rate of return on investment should be employed for calculating high cost support for rural carriers[28], FW&A believes that in order to maintain predictable and sufficient support levels, the FCC authorized rate-of-return continue to be used until modified by the FCC. This proceeding is not the appropriate proceeding to address changes to the authorized rate-of-return. The FCC periodically examines and modifies the authorized rate of return that is applicable to rate-of-return regulated carriers.

In the Public Notice it requested whether the Commission should consider averaging costs over larger areas or smaller areas for high-cost loop support and other programs. For example, should the Commission consider calculating support based on statewide

[27] If network connections were employed as the cost basis for determining support, the national average benchmark of $240.00, as specified in C.F.R. Section 36.622(a), would need restatement so that it would be on an equivalent basis.
[28] Public Notice, Para. 39

average costs or wire center costs, rather than study area costs? [29] The use of statewide average costs would significantly penalize rural LECs. Rural LECs with higher costs would be averaged with those LECs with lower costs and consequently support or costs would be artificially lowered. With support determined on average statewide cost level, an LEC with costs higher than the statewide average may not realize support that is sufficient to recover its costs and maintain affordable rates. Use of statewide average cost is nothing more than a method to reduce support levels and is not based on an individual service provider's costs. Determining support for rural LECs based on the statewide average costs is inappropriate and could harm rural LECs. While the use of statewide average costs may be workable for larger LECs, since they have a greater ability to support high-cost rural areas they serve with revenues from low-cost metropolitan areas they serve, it will not work for rural LECs. Typically, small rural LECs exclusively serve high cost rural areas. Thus, there are no low-cost areas to support or pick up the shortfalls in cost recovery for the high-cost areas. As the RTF pointed-out, statewide averaging would have the effect of eliminating a significant amount of federal support received by rural LECs. The burden of recovery of the costs of universal service would shift to the States which would cause the need for burdensome regulatory proceedings and possibly leave universal service cost recovery in limbo. There is no reason to shift this cost recovery burden. A reasonable balance has been struck between Federal and State universal service funding and this balance should not be upset.

[29] Id. Para. 41

Unlike statewide average costs, wire center costs more accurately depict costs for universal service support purposes. That is by isolating costs by wire center, support from low-cost wire centers that is flowing to high cost wire centers becomes explicit rather than implicit. The drawback to utilizing wire center based costs is that they would impose additional administrative burdens for the calculation of support, since most rural LECs do not account for costs at the wire center level. Continuing to calculate rural LECs' support at the study area level for determining universal service support appears to represent a reasonable compromise. Rural LECs study areas are typically small and only serve a few wire centers. Many rural LECs only have a single wire center in their service area. Thus, for many rural LECs, not much is gained by calculating support below the study area level. Moreover, since the rules allow support to be disaggregated, LECs can more accurately target support amounts to smaller areas within their study area if they so desire.

Comment is sought by the Joint Board requesting whether there is a continued need to provide support for carriers with high switching costs through Local Switching Support (LSS).[30] LSS is a vital portion of cost recovery for small rural LECs. All of the FW&A client companies' service areas are much smaller than 50,000 lines[31] and LSS recovers a significant portion of the high costs associated with providing switching in their rural areas. FW&A supports the retention of the LSS recovery mechanism for rural LECs. Elimination of LSS would result in the loss of cost recovery and threaten predictable and

[30] Public Notice, Para. 46

[31] FW&A does not have extensive amounts of switching cost information to enable it to assess whether 50,000 lines is a reasonable qualification criterion for receiving LSS. The Joint Board would need to gather data cost from LECs that differ in size to assess the reasonableness of the 50,000 line qualification criterion.

sufficient support that is necessary for the availability of universal service. Additionally, there is no compelling need to merge LSS and high-cost loop support. Both mechanisms are functioning effectively for rural carries.

The Joint Board also seeks comment on whether carriers that experience high transport cost should receive support. Rural carriers with high transport costs are already receiving support for high transport costs. The majority of high transport costs that were formerly recovered through the Transport Interconnection Charge have been predominantly reallocated to the Interstate Common Line Support (ICLS) mechanism. Thus, ICLS provides support for the recovery of high transport costs and there is no need for additional support mechanisms.

IV. SUPPORT FOR TRANSFERRED EXCHANGES

The Joint Board seeks comment that if the Commission concludes that it should maintain separate support mechanisms for rural and non-rural carriers, should it retain, repeal or further modify Section 54.305 of the rules concerning universal support for transferred exchanges?[32] Currently, the rules require that if a carrier acquires exchanges from an unaffiliated carrier it receives universal service support (high cost loop support, LSS, non-rural carrier high-cost model support) for those acquired exchanges at the same per-line support levels for which the exchanges were eligible prior to transfer. Additionally, a carrier may be eligible for safety valve support for the recovery of subsequent investments made to upgrade the acquired exchanges. Safety valve support allows a

[32] Public Notice, Para. 48

carrier to recover up to 50% of the annual costs[33] of upgrades in excess of the index year costs (typically the first year the exchange is operated).

The Joint Board should consider modification of these rules as they pertain to rural carriers. Rural carriers are typically small and can not significantly impact the size of the fund through acquisitions. As such, carriers defined as rural should be allowed to incorporate acquired exchanges into their existing study areas and determine costs in accordance with the existing cost formulas contained in Part 36. This would eliminate the high cost and LSS support being frozen at the level that existed prior to the purchase. The problem with the frozen level is that the prior carrier operating the exchanges may have not performed routine or necessary upgrades to allow the facilities to be capable of delivering quality services and advanced services. This is often the case in rural areas where exchanges are for sale. The former owner typically has not upgraded the facilities and rather than upgrade, they choose to sell the exchanges and or the company. There are several cases in rural areas where the buyer only purchases individual exchanges and not the entire company. If a rural carrier purchases the exchanges, they may not have a sufficient level of universal service funding that is necessary to recover costs of the upgrades, since the high cost support is frozen at a level that reflects lower costs and significantly depreciated plant. While the safety valve mechanism provides for up to 50% of the recovery of the additional costs of upgrades, the level of recovery that may be obtained could be less because the overall safety valve support is capped at 5% of the

[33] The costs are determined in accordance with the rules contained in Part 36, Subpart F concerning the calculation of the high cost loop expense adjustment.

total nationwide loop cost expense adjustment[34]. Further, since the safety valve mechanism requires an index year to be established and another full year to pass for comparison of cost with the index year cost and with built-in delays for USF reporting, it can take over 2.5 years before a carrier can receive funding. This serves to automatically delay upgrades to the exchanges, since a carrier has the incentive to wait one-year before upgrades are made to not jeopardize much needed cost recovery from the safety valve mechanism. Another problem with safety valve support is that the rules require that the acquiring LEC to treat the acquired exchanges as though they are a separate study area for USF purposes. This imposes additional accounting requirements and can be burdensome on small rural LECs that acquire exchanges as well as those that administer the funds.

To provide rural carriers with additional incentives to acquire exchanges in rural areas where advanced services may not be available, FW&A supports that high cost loop support and LSS no longer be frozen at the pre-acquisition amounts. Rather, a carrier should be allowed to incorporate costs into their existing study areas and calculate the high loop cost expense adjustment pursuant to rules contained in Part 36. This will allow an appropriate level of cost recovery.[35] Making support fully available to rural companies acquiring exchanges will promote additional investment in infrastructure in rural America and make advanced services available in areas where they currently don't

[34] See C.F.R. Section 54.305(e). If the Commission elects to retain the safety valve mechanism, it should remove the future uncertainty imposed by the cap and eliminate it.

[35] If the Commission is concerned about growth of the fund as a result of acquisitions, it could only impose the frozen support amounts on large companies that acquire exchanges. For instance, the Commission could require that frozen per line amounts only be applied to companies that serve more than 100,000 lines nationwide. Companies under this threshold could simply incorporate the acquired exchanges into the existing high cost loop formulas.

exist. If this procedure is limited to small rural LECs, it should not cause undue growth in the Universal Service Fund.

V. SUMMARY

To summarize, FW&A provides the following comments and recommendations regarding the rural mechanism that will succeed the five-year plan adopted in the RTF Order:

- The current definition for "rural" should be supplemented with a criterion that would assess the population density of the study areas served statewide by an ETC. Under this approach, the definition would more accurately depict those rural service providers that serve areas with sparse population densities and do not benefit from economies of scale and scope. An initial criterion that could be evaluated by the Joint Board is 100 people per square mile.

- Carriers impacted by the change in the definition of rural should have the option to flash-cut to the forward-looking cost-based support levels on the effective date or to transition to the new support levels over a five year period.

- FW&A supports the continuation of the use of embedded costs for carriers that meet the rural definition as the approach to determining universal service support that best meets the Act's goals. Only actual or ECOS can serve as a reasonable basis to ensure that a rural LEC receives sufficient and predictable support that is necessary for maintenance of affordable rates.

- If an alternative FLEC model is developed or significant modifications are made to the FCC Synthesis Model and applied to rural LECs, the RTF should be reconvened to evaluate the sufficiency of the model for purposes of calculating universal service support.

- A fundamental requirement should be that for CETCs to receive support they must demonstrate a need for it based on their own costs. If a CETC, including a wireless carrier, is defined as non-rural it should be required to utilize FLEC costs and related support mechanisms that are applicable to non-rural carriers. If the CETC is defined as a rural provider, its support should be based on its ECOS similar to the rural LECs. Alternatively, if the wireless provider does not want to file its own costs, it could elect to base its support on the incumbents' amounts subject to the tier adjustments recommended by the Rural Telephone Associations in comments previously filed in this Docket.

- The depiction of costs based on proxy items such as line counts and population density would be arbitrary and not produce accurate costs. This arbitrary cost depiction would likely misestimate costs and not ensure that rural LECs receive sufficient universal support levels.

- It would be more efficient to base support on the number of voice-grade network connections that are available in a LEC's network as this is more consistent with

how costs are incurred. As a result, the support per unit would not decline as line counts (in-service) decline.

- The use of statewide average costs for determining universal service support would significantly penalize rural LECs. Unlike non-rural LECs, rural LECs are not able to average higher cost areas with lower cost areas to offset the need for universal service support.

- The LSS recovery mechanism for rural LECs should be retained. Elimination of LSS would result in the loss of cost recovery and threaten predictable and sufficient support that is necessary for the availability of universal service.

- To provide rural carriers with additional incentives to acquire exchanges in rural areas where advanced services may not be available, high cost loop support and LSS should no longer be frozen at the pre-acquisition amounts. Rather, a rural carrier should be allowed to incorporate costs into their existing study areas and calculate the high loop cost expense adjustment pursuant to rules contained in Part 36

Respectfully submitted by,

_____

Paul L. Cooper
Director of Operations, Fred Williamson & Associates, Inc
2921 East 91st Street, Suite 200
Tulsa, OK. 74137-3355
Telephone: (918) 298-1618